Statement by the

NATIONAL CATTLEMEN'S BEEF ASSOCIATION

on

Preserving and Protecting Family Business Legacies

Submitted to the

Senate Finance Committee
Subcommittee on Taxation and IRS Oversight

The Honorable Don Nickles, Chairman

by

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Sand Springs, Montana

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Chairman Nickles and Distinguished Members of the Senate Finance Committee:

On behalf of the National Cattlemen’s Beef Association (NCBA), which is the trade association of America’s cattle farmers and ranchers, and the marketing organization for the largest segment of the nation’s food and fiber industry, thank you for your interest in my comments regarding the burden that the death tax places on hard-working American families. I appreciate the opportunity to share with you the devastating affect death taxes have on the ability of cattlemen and women to pass their family businesses on to the next generation.

I am a rancher from Sand Springs, Montana, a small community about 160 miles northeast of Billings. My family has ranched in Montana since the early days of the 1900s. I am a member of the National Cattlemen's Beef Association, the Montana Stockgrower's Association and the Public Lands Council.

For the past several Congresses, relieving the death tax burden has been a top priority for NCBA. We commend the Committee’s hard work in making significant progress toward the ultimate goal of eliminating death as a taxable event from the federal tax code. Through our own resources and as a member of the Family Business Estate Tax Coalition, we are committed to working with you and the Committee to making repeal of death taxes a reality. This hearing is evidence that repeal of death taxes remains a top priority for many Members of Congress.

From the cattle industry’s perspective, the death tax is the primary obstacle in keeping our family-owned businesses intact and viable during the transition from one generation to the next. Nearly one-half of our members have been in business more than 50 years and 15 percent of our members have operated their family business for more than 100 years. These are the folks who for generations have contributed to the economy of the local communities, and who are the foundation of an industry that represents 20 percent of the U.S. agricultural gross domestic product (GDP).

The agricultural GDP annually generates over $150 billion in local and national economic activity. When you add the high level of economic activity from the public monies generated, such as fuel taxes, property taxes, excise taxes, income taxes and related revenues, one must question the wisdom of a federal policy that effectively erodes the base of the rural economy.

I pay over $20,000 in real estate taxes and $3,600 in personal property tax each year. Other taxes, such as state and federal income taxes vary greatly because, as a rancher, I do not control the price I receive for my product or what is paid for goods and services.

My grandfather came to Montana in the late 1800’s and homesteaded near Broadus, Montana. He passed away in the 1940s and my grandmother eventually sold that ranch to help my parents purchase the ranch that my wife, Cheryle, and I operate, along with my son, Matt, and his family today. My family has operated this ranch since 1955, and I am proud to be a third generation Montana rancher.

My parents were determined that my brother and I would get an education. That meant I would be going to college and my mother would have to move to town so that my brother could attend high school. My father could not operate the ranch alone, so my parents chose to move to Missoula, Montana where we could both attend school. They leased out our ranch and sold all of the livestock in 1968 so that we could continue our education.

In 1973, when I finished college, my brother and I moved back to the ranch, and we purchased livestock and equipment to begin ranching again. In order to undertake this venture, we had to go into debt. Also, during this time, my mother and father were going through divorce proceedings. To pass on part of the ranch and to reduce the size of the estate, their agreement stipulated that my father's half of the ranch be split between my brother and myself.

My brother was killed in a crop spraying accident on our ranch in 1980. As a result of his death, his property, and his one-fourth of the ranch went back to my mother. At that time, my mother was assessed a state death tax of $5,891 on my brother's one-fourth, even though my father used the unified credit to gift his part of the ranch. By then, she had decided to move back to the ranch and had sold the Missoula home, and invested the proceeds into stocks.

In 1981, to consolidate assets, my family formed Bliss Livestock Corporation. My mother, father and I contributed land and other assets and each party owned 70 percent, 21 percent, and 9 percent respectively. My mother's share included the property she had inherited from my brother.

I managed the entire operation after my brother’s death in 1980 and accumulated debt to fund growth. During the mid-eighties, my mother started gifting to me Bliss Livestock Corporation, in order to decrease the value of her estate. My mother had lived through the "Great Depression" and it was very difficult to convince her of the necessity of more extensive estate planning. My lawyers, accountants and I continued to urge her to do more, but her Depression era experience was worth more to her than any advice regarding the future. Given her reluctance to reduce the size of her estate, in 1991, I purchased a $200,000 life insurance policy on her that cost me $81,800 over four years.

My mother and father both passed away in 1998 and I inherited their share of Bliss Livestock Corporation, as well as a $92,000 federal death tax bill and a $29,000 state death tax. Because we had used the unified credit in my brother’s passing, the amount of unified credit that could be used toward the death tax when my parents passed away was decreased, making this death tax bill larger than it otherwise would have been.

On the positive side, just prior to my parent's passing, Congress had created a special family business exemption. Had that not occurred, my death tax would have been in excess of $425,000 and I would have been forced to liquidate the assets that my family depends upon for a living.

Ranching is a debt intensive business. Over the years I have been indebted to fund short-term obligations to operate on a daily basis, and long-term to buy property and equipment. I have averaged about $650,000 in long term debt, not including taxes, to fund the operation. I currently have roughly $400,000 in long-term debt and a $l40,000 short term debt that I am paying on annually.

Debt has to be repaid out of operating income from farming and ranching revenue. When crop prices are low, as they have been for the past several years, and calf prices are low like they were in the 90s, it is difficult to make an operation cash flow. For the next thirteen years, I will be paying off the death tax debt. Add in my operating debt payments, income taxes, and high operating cost, it becomes difficult to stay in business.

To create an economically viable operation, I have tried to do all the right things. I have grown the business, invested wisely and increased the value of my operation by making improvements. I have also initiated environmental stewardship projects that improve water quality, wildlife habitat and pasture management. Notable organizations and institutions have recognized our innovation and hard work such as our ranch being featured in the Winter Grazing Success booklet, and as a host ranch for the Governor's Range Tour in Montana.

We are currently working on a 26 mile water pipe line, on mostly federal land, to improve range conditions by providing additional water sources for cattle and wildlife. This project cost us over $70,000 last year and we will have to spend another $40,000 to complete it this year. Most of this money is borrowed so we will be several years paying back the loan. I believe that environmental stewardship is one of the most important things we do as ranchers, and we want to pass on the ranch to the next generation in better shape than we received it. The money for everything we do in this regard comes from the family ranch.

Everytime we have made a profit, we have reinvested it back into the ranch to improve or expand our operation, but a tax of $92,000 is a lot to take from a family business. If my wife Cheryle and I were to die right now, I don't believe we would be able to leave our ranch to my son Matt and his family.

My wife and I were able to expand in the 90's and currently our estate is worth $7 million. With the present death tax, my son would have to pay $1.5 to $2 million to the federal government and a significant amount to the state of Montana. In order to pay the tax he would need to sell a large portion of the ranch. This would leave him a ranch that is less efficient and less economically viable.

I have been gifting shares to my son, but at the current non-taxable gift level it could take up to 700 years to gift the entire estate to him. Life insurance is an option, but a $1.5 million policy is cost-prohibitive given the payments I must make on the current death tax and my operating debt. Even if my son could arrange to pay a $2 million death tax bill over 10 years, he would still owe over $200,000 a year plus interest. A ranch like ours just does not generate that much cash flow.

Ranches the size of ours are the lifeblood of small rural communities. We are large enough to provide jobs, and purchase large amounts of goods and services that support main street businesses. Death tax not only takes money out of the pockets of hard working ranch families: it is also money that I can't invest in my business or use to support my rural community.

I started working this ranch at six years old driving a tractor in the hay field. The assets I received from my parents were not a windfall. I operated the ranch for 25 years before they died, and took a great deal of financial risk that almost cost us the ranch in the early l980's. I started in l973 with an old house and a couple of old wooden sheds and with years of hard work and good management, our ranch today is one of the most productive and improved ranches in the county. Hard work should be rewarded, not penalized by a death tax.

Our ranch is more than just a business or a home; it is a lifetime commitment by past, present and future generations. We have worked hard all our life on this ranch, and at some point we'd like to be able to do more than buy fence posts and insurance policies. This is my reality, but could become my son's nightmare if the death tax is not eliminated.

Some would have you believe that only the richest 1 or 2 percent ever pay death taxes. My wife sure doesn't feel rich; she still has the same old carpet that was put in the house in 1976.

Death is a certainty for each of us. Unfortunately, it also unleashes the IRS, which can take up to 55 percent of a business and its assets before the next generation has the opportunity to carry on the family tradition. Statistics indicate the average age of a cattleman is 55 years, which suggests there currently are a lot of ranch families who will soon face the burden of federal death taxation. Statistics also indicate that the number of cattle operations has declined 20 percent since 1981, a trend that many feel is accelerated by the burden death taxes pose on surviving family members.

NCBA feels this burden has contributed to families selling their family farming and ranching enterprises in anticipation of the death tax. In addition, many of our members report that their efforts to plan for the impact of death taxes has led to management decisions that are not always in the best interests of operating a profitable enterprise.

We also believe, in addition to enhancing the well-being of the beef industry, that death tax reform will provide society in general with environmental benefits. Any business that is successful over a long period of time is one in which the principals pay close attention to the maintenance, up-keep and improvement of the production facility. For cattlemen, their production facility is the land -- land that they and their ancestors have nurtured to ensure its ability to support their beef herds, and land that they share with a natural ecosystem that includes wildlife habitat, watersheds, and riparian areas.

A cattle operation is a capital-intensive enterprise typified by having most of its assets invested in the land or cattle. In the event of the death of a principal family member, the sale of the land and/or cattle becomes the primary source of funds available to meet the costs of death taxes. When this occurs, ranches or farms get split up, particularly in areas of aggressive urban/suburban growth and escalating land values. The net result is that land that once provided nutritious beef or other staples for our diets and habitat for Mother Nature's flora and fauna is instead used to grow houses, shopping malls, and roads.

Taxing capital at death is frustrating when one considers that the money used to buy, maintain and improve these assets was taxed when earned. Adding to the insult are the death tax rates which can impose a top rate of 55 percent -- which is especially troubling when compared to the top capital gains tax rate for individuals of 20 percent.

NCBA is a member of the Family Business Estate Tax Coalition, a large group made up of trade associations and organizations representing the vast majority of this nation's family owned enterprises. This group has worked in a bipartisan fashion to build the case of the negative impact that the death tax places on family businesses. The message of the Coalition is simple, and perhaps redundant, but it needs to be repeated.

Liquidity is the fundamental characteristic that distinguishes the estates of family owned businesses from those of individuals holding marketable securities and/or other liquid assets. Publicly traded stock can be sold to pay the death tax, doing little harm to capital investments that are critical to the productivity of the business and the overall financial well-being of a company. But a family-owned business, whether it's a ranching operation or a restaurant, must sell critical assets -- and often the business itself must be sold -- to pay death taxes, or suffer under the resultant debt load necessary to continue in business.

Our campaign to repeal the death tax is about jobs, economic growth and the financial stability of this nation's small and medium sized communities. On behalf of the NCBA, we thank you and your colleagues for holding this hearing. We encourage you to move boldly in your efforts to provide relief from the burden of the death tax.

Thank you Mr. Chairman for the opportunity to visit with you and the Senate Finance Committee today. I look forward to further discussion on the death tax which has such negative consequences on family businesses and rural communities. I will be happy to answer any questions you or the Committee may have.